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NO. 305

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

A. J. WHIPPLE AND MILDRED WHIPPLE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

QUESTION PRESENTED

The sole issue in this case is whether the $56,975.10 debt of Mission Orange Bottling Co. of Lubbock, Inc., to Petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Section 23 (k) (1) or Section 23 (k) (4), respectively, Internal Revenue Code of 1939.

It was stipulated (1) that it was a debt; and (2) that it became worthless in 1953. (R. 56).

This turns on whether or not the loss resulting from the debt's becoming worthless bore a proximate relationship to the conduct of a business in which Petitioner, A. J. Whipple, was engaged at the time it became worthless. T.R. 39.23(k)-6(b).

POINTS ON REPLY

First Point

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

Second Point

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.

ARGUMENT

First Point Restated

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

The real issue presented in this case is whether the activities of Petitioner who engaged in extensive, varied, continuous and regular activities of organizing with many different people, many different corporations, partnerships and joint ventures over a period of years, to carry on many different types of business, in many different localities, and financing, managing and equipping such enterprises for which he received $94,478.71 as ordinary income in the years 1952 and 1953 in the form of salaries, rent and interest, and who incurred a bad debt loss resulting from a loan made to one of those corporations, were business activities or merely investment activities.

If these activities were business in character, the bad debt loss incurred therein would be a business bad debt within Section 23(k)(1) of the Internal Revenue Code of 1939.

In other words as this Honorable Court pointed out in the case of *Putnam v. Commissioner*, 352 U.S. 82; 1 L. Ed. 2d 144, one of the main purposes of the insertion of Sec-

tion 23(k)(4) was to deny the full loss for a bad debt incurred in connection with an *investment*. In commenting on the purposes of the comprehensive tax plan enacted by the Revenue Act in 1942 the court said:

> "Equally, however, the plan was suited to put non-business *investments* in the form of loans on a footing with other non-business *investments* * * * We may consider Putnam's case in the light of these revealed purposes. His venture into the publishing field was an *investment* apart from his law practice." (Empnasis supplied).

The Respondent states his position on page 23 of his brief as follows:

> "Organizing, financing and managing one or more corporations does not constitute a 'trade or business' of a taxpayer-stockholder if he engages in these activities without compensation, *looking for his reward solely to an increase in the value of his corporation's stock*. This is the central proposition upon which our case rests." (Emphasis supplied).

Without quarreling with the rule advanced by Respondent, it certainly is not applicable to the facts in this case. Rather than "looking for his reward solely to an increase in the value of his corporation's stock", Petitioner, Whipple, received his "reward" in the form of salaries, interest and rents. Petitioner organized, financed and managed numerous corporations, partnerships and joint ventures, looking for his reward not from an increase in the value of his stockholdings but from ordinary income received from entities he created to avail themselves of his services and pay him salaries for his managerial and organizational

services, pay him interest on the money he loaned to them, and pay him rent for buildings which he leased to them.

It was these goals as distinguished from an intent to increase the value of his investments that occasioned his receipt in 1952 and 1953 of $94,478.71 in salaries, interest and rents and $56,376.28 as partnership income.

Respondent consistently emphasizes that there must be a sale or exchange for there to be a business. That element of business was not ignored in Petitioner's situation or in his course of conduct. Petitioner performed services for the various enterprises with which he dealt. To some that service was the organization or creation of the entity so that it might engage in a business of its own. To others, or those same entities, he performed the service of obtaining financing for them. To some he loaned money. To still others, and again some of the same, he performed managerial services. He also provided them the buildings out of which to operate. Most frequently, these services were performed in concert. The commodity which he sold was not an inventory of corporations but himself, the use of his money and the talents which he possessed in those fields. Most of the enterprises were able to compensate him for that commodity but, unfortunately, Mission Orange was not. The fact that no compensation was paid does not show that the service was not performed or that the business did not exist. Every merchant is familiar with the customer to whom goods are sold or for whom services are performed but who fails to pay for them. If no payment is received, does the sale or service evaporate or the merchant's business disappear? Certainly not. By the same token, Petitioner's services were real and beneficial and the debt

owed him by Mission Orange was an integral part of his business.

A realization on the value of an investment can come about in only one of two ways. It may come in dividends or by the sale of the investment. Contrasted with the $94,478.71 received by Petitioner from rent, interest and salaries the Petitioner received only $3,300 from dividends in the years 1952-1953 (R. 154; 175), and the Tax Court correctly found that he did not form the corporations for sale. (Tr. 31). Therefore, the rule sought by the Respondent simply has, and can have, no applicability to the case before this Court.

Having stated a rule that does not apply to Petitioner, Respondent in his brief then goes on to give two illustrations of persons who would qualify for bad debt treatment under his theory, but who do not resemble Petitioner. He thus implies that because Petitioner is not one of such type of persons, he, therefore, does not qualify for business bad debt treatment.

The two types mentioned both fall under the category of promoters. The Respondent asserts that (Br. 28):

> "The true promoter obtains compensation in return for his services in one of two ways:
>
> '"(i) He may, as a consistent practice, set up corporations with a view to *holding them for sale or resale* as soon as they achieve going-concern status. In such a case, the corporations would constitute the inventory or stock-in-trade of his individual business of 'dealing in corporations', and the proceeds of the sales would have to be reported as ordinary income. In Giblin v. Commissioner, 227 F. 2d 692, the Fifth

> Circuit (per Judge Tuttle, who also wrote the court's opinion in the instant case) held that such trafficking in corporations constituted a separate business of the taxpayer." (Emphasis supplied).

It was the narrow limitation of the allowance of the business bad debt deduction to the type of person who, as the Tax Court put it, is "in the business of dealing in corporations" (R. 31), or, as the Court of Civil Appeals describes it, is in "the business of dealing in enterprises" (R. 136), one who is "regularly engaged in the business of seeking out business opportunities, promoting, organizing, and financing them, contributing to them substantially 50% of his time and energy and then *disposing of them at a profit or loss*" (R. 136), which is the cause of the error committed by the courts below. (Emphasis supplied).

As pointed out in Petitioner's original brief at page 52, the fact the Petitioner never held an inventory of corporations for sale is demonstrated by his treatment as capital gain, rather than ordinary income, the proceeds of the liquidation at book value of his minority interests in corporations and partnerships he owned with Strickland. (R. 94)

Respondent admits that the requirement made by the courts below that the corporations must be held for sale is entirely unrealistic by saying in footnote 9 on page 28 of his brief:

> "9. Whether the facts of Giblin—or, for that matter, of any of the decided cases—actually fit that description may, of course, be doubted. The possibility is, indeed, probably more theoretical than real, since the

taxpayer who maintains an 'inventory' of 'corporations' for sale is more readily imagined than found."

Being faced with that enigma, he adds a corollary that a true promoter may also "organize corporations for others in return for a fee or commission" (Br. 28). Actually, as a practical matter, this broadening of the meaning of "dealer in enterprises" to include the promoter who collects a fee would bring very few, if any, more cases under the business bad debt deduction provisions of Section 23(k) since this type of promoter, after helping to organize a corporation, usually simply collects his fee and moves on to promoting another. Therefore, he would have no part in managing the corporation. In those cases where, in the words of Respondent's brief (Br. 30), "he has converted his fee into an investment in the corporation, the *investment thereafter being a separate venture having nothing to do with his promotional business*," there would be no justification under the narrow rule applied by the courts below for allowing him business bad debt deduction even if, in fact, he did manage the corporation. (Emphasis supplied). Furthermore, the real promoter would never be financing the corporation. If he had the funds to do so, he would not have to promote ventures. In the words of Professor Ballantine, quoted by Respondent (Br. 28), "The primary function of the promoter is to find an enterprise and *interest investors in financing* a proposed corporation to take over." (Emphasis supplied).

Thus, the application of the rule applied by the courts below amounts to a decision that Congress, by the insertion of Section 23(k)(4) into the Internal Revenue Code back in 1942, really intended to preclude the deduc-

tion as a business bad debt of any loan to a corporation in which the taxpayer is interested.[1]

Such an extreme result is not only illogical but goes squarely in the teeth of equity, sound public policy, Treasury rulings,[2] the intent of Congress,[3] good tax law, and the long established rule of the cases.[4]

Where continuous and regular activity produces income which is taxed as ordinary income, losses occasioned by such activity should be treated as ordinary loss.

Taxpayers engaging in what has been considered for years as business activities, who have been taxed on ordinary income as a result of such activities and who take

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[1] This was pointed out by Judge Hutcheson in his dissent as follows (R. 143):

> "It seems to me that the basic fault of the majority opinion is holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If Congress had so intended, it could and would have so provided. Not having done so, neither the Tax Court nor this Court can construe the statute as though it contained such provision."

[2] **Cluett v. Commissioner,** 8 T.C. 1178 (1947) Acq. 1947-2 C.B. 2; **Campbell v. Commissioner,** 11 T.C. 510 (1948) Acq. 1949-1 C.B. 1; **Sage v. Commissioner,** 15 T.C. 299, Acq. 1951-1 C.B. 3.

[3] See **Putnam v. Commissioner,** 352 U.S. 82, 1 L. Ed. 2d 144.

[4] **Campbell v. Commissioner,** 11 T.C. 510; **Mays v. Commissioner** (6 Cir.), 272 F. 2d 788, 60-1 U.S.T.C. para. 9122; **Maloney v. Spencer** (9 Cir.), 172 F. 2d 638, 49-1 U.S.T.C. para. 9176; **Commissioner v. Stokes' Estate** (3 Cir.), 200 F. 2d 637, 53-1 U.S.T.C. para. 9164; **Sage v. Commissioner,** 14 T.C.M. 1029; **Alexander v. Commissioner,** 34 T.C. 758; **Trent v. Commissioner** (2 Cir.), 291 F. 2d 699, 61-2 U.S.T.C. para. 9506; **Maytag v. U. S.** (U. S. Court of Claims), 289 F. 2d 647, 61-1 U.S.T.C. para. 9424; **Foss v. Commissioner** (1 Cir.), 75 F. 2d 692, 35-1 U.S.T.C. para. 9091; and see also **Washburn v. Commissioner** (8 Cir.), 51 F. 2d 949, 2 U.S.T.C. para 794.

the risk of assuming the same tax treatment for losses, should not be suddenly caught in a radical departure from the established rule, such as was done by the courts below and is urged by the Respondent.

While taxing statutes cannot be given the durability of a rule of property because to do so would deprive the legislative body of the power to meet changing economic needs, the tax laws should not be suddenly changed by judicial construction, as was done by the lower courts.

As we have shown, the rule sought by the Respondent would apply only to the rare, if not purely theoretical type of promoter who holds an inventory of corporations for sale. This is the promoter who initiates an enterprise, makes someone else pay him for it, drops it and goes on to another, to get ordinary loss treatment. On the other hand, under such a rule, the small businessman who not only initiates the enterprises, but who goes on to finance and manage them and pays tax, year after year, on the ordinary income he has generated in the process, would be forced, when he sustains a loss, to have his tax deduction virtually eliminated. Although ordinary income is taxable in full, the holding of a debt to be a non-business bad debt may result in a taxpayer's being able to deduct only $1,000 of it if he has no capital gains against which to offset it.[5]

Recently the President recommended a bill to Congress giving tax relief to stimulate business.[6] It is hard to think

[5] Section 117(a)(10)(B) IRC 1939 "OTHER TAXPAYERS—In the case of a taxpayer other than a corporation, the term 'net capital gain' means the excess of the losses from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over the losses from such sales or exchanges.

[6] U. S. Code Congressional And Administrative News, 1963, No. 1, page 43.

of anything that could do more to discourage enterprising small businessmen, such as Mr. Whipple, than to allow the theory applied by the lower courts to become the law. It could discourage them from organizing new enterprises, from creating new jobs, from stimulating more spending and generating more taxable income to fight against the threat of recession and to stimulate national growth.

Respondent, recognizing that the holding of the courts below cannot meet the test of either logic or practicality, in an effort to bolster such decisions tries to broaden the meaning of the rule laid down.

For the reasons set forth in detail in Petitioner's brief (Br. 45-49) Petitioner readily confesses that he is considerably confused, as must be other taxpayers, and, as the cases show, have been several courts[7] as to what rule is followed in the Fifth Circuit, but we submit that very convincing evidence of the rule that was applied to *this* taxpayer in *this* case comes from Judge Hutcheson who sat in on the deliberations and the decision in the case, when he stated:

> "The taxpayer in the Cluett case was certainly not in the business of selling stock exchange seats, and Mr. Campbell was not in the business of selling coal companies. Yet the government contends, and the tax court and the majority have erroneously held, that in order for the loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed, and managed were formed by him for sale. This extension of the re-

[7] **Holtz v. Commissioner** (C.A. 9), 256 F.2d 865, 870, T.C. Memo 1957-106. **H. Beale Rollins,** 32 T.C. 604, aff'd (4th Cir.) 276 F.2d 368, 60-1 U.S.T.C. para. 9357; **Vreeland v. Commissioner,** 31 T.C. 78.

striction on the qualification of business bad debts contended for by commissioner and tax court considerably restricts the remedy which congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law."

Second Point Restated

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.

The Tax Court and the majority of the Court of Appeals held that Petitioner was not entitled to a business bad debt deduction unless he could show (1) that he was a dealer in corporations having organized them for sale; or (2) that he was in the recognized business of lending money; or (3) that he was in the business of actually bottling soft drinks.

The courts below failed to make any finding with regard to Petitioner's assertion that his activities, when considered in combination, constituted a separate and distinct business to which the $56,975.10 bad debt loss was proximately related. The courts below apparently failed to recognize the distinction between mere investment activities and actual business activities, which, although not stereotyped, existed and were evident.

The dissenting judge in the Court of Appeals grasped the import of Petitioner's argument and the significance of his course of conduct when he wrote (R. 138):

> "The taxpayer is here insisting that the tax court below and the government in its brief and on oral argument have failed to recognize, and give effect to the fact that, though taxpayer's activities which gave the debt rise might not lend themselves to a specific name or label, they were certainly of a business nature within the meaning and intent of the act, in that the petitioner engaged in them for the purpose of deriving income therefrom, and the bad debt loss suffered had a direct relationship to the conduct of these business activities."

Also, it was the failure to take into account that a taxpayer may be in more than one business that caused the Courts below to err.[1]

Petitioner sought his "reward", not from an enhancement in the value of any single stockholding, but rather in the form of salaries, interest and rents as a result of his complex activities in connection with the broad scope of his undertakings in organizing, financing, managing and leasing to corporations. His activities included the interesting of other people in his enterprises as well as himself.[2]

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[1] See **Harvey v. Commissioner** (9 Cir.), 171 F. 2d 952, 49-1 U.S.T.C. para. 9124; **Fackler v. Commissioner** (6 Cir.), 133 F. 2d 509, 43-1 U.S.T.C. para. 9270; and also **Washburn v. Commissioner** (8 Cir.), 51 F. 2d 949, 2 U.S.T.C. para. 794, where the court said:

> "The statute does not provide that to secure the benefits the taxpayer must be engaged in only one business. It is any 'trade or business'. A party may be engaged in many kinds of business and still be entitled to the benefit of the statute."

[2] W. E. Brown (R. 85); Miles Strickland and W. C. Perkins (R. 85); Bentley Strickland (R. 88); George Lesti (R. 88); John W. Anderson

The Respondent places great reliance in his brief on *Dalton v. Bowers*, 287 U.S. 404, and *Burnet v. Clark*, 287 U.S. 410, but neither has any application to the facts in this case.

In the *Dalton* case, the question of whether a taxpayer should be allowed a full loss on debts the corporation owed him was not before the Court. Apparently, the bad debt losses had been allowed in full for loans to the corporation under the then existing law. The question was whether the loss on stock which had become worthless in 1924 could be carried forward to 1925 as a loss attributable to the operation of a trade or business. The Court stated:

> "He testified that his primary purpose in this venture was to perfect his sundry models and patented articles and *sell the corporation shares profitably;* he thought it would be better to market such articles through the corporation, to have the business in corporate form; he considered the *corporation as a branch or part of his own business* as an inventor and dealer in patents, etc.—as a means to an end; an instrumentality of his purpose. * * *" (Emphasis supplied).

In denying Dalton's assertion that the corporation was a part of his individual business, this court quoted from the opinion of the Circuit Court of Appeals as follows:

> "There is no justification for saying that the business of the corporation was that of the Appellee * * *"

(R. 90); V. L. Yarborough, L. R. Olive, G. A. Durham (R. 100); D. M. Dozier (R. 100); Bill McKinney (R. 106); James Finley (R. 45), Cecil Clark (R. 45); Dora B. Ellzey (R. 45); Jack Knostman (R. 45); James F. Webster (R. 45), Head (R. 65).

> "* * * The loss now sought to be deducted was an investment which he made in the corporation and did not occur in the operation of a trade or business *regularly carried* on by the appellee * * *."
>
> "By the statute allowing the deductions and carrying over the loss for two years Congress intended to give relief to persons engaged in an established business for losses incurred during a year or depression in order to equalize taxation in the two succeeding and more profitable years. It was not intended to apply to *occasional or isolated* losses." (Emphasis supplied)

It is significant to notice also that the petitioner in the *Dalton* case was the sole stockholder. There was no indication whatever of any activities in interesting other people to invest and take part in different enterprises.

The distinction between *Dalton* and this Petitioner is that Dalton sought to establish an identity between his own business and that of the corporation. On the other hand, Petitioner's activities were organizing, financing and managing corporations, partnerships and joint ventures which is certainly not the business of bottling soft drinks, subdividing real estate, running a restaurant, leasing equipment, selling lumber, building houses, etc.

In *Burnet v. Clark* (supra) the taxpayer was the majority stockholder in the Bowers Southern Dredging Company, a corporation which did river and harbor improvement work. After 1917, the corporation encountered continuous financial difficulties. The taxpayer sought to carry forward as a net operating loss to apply against taxable income in 1923, $68,000 paid by him on endorsements of the company's notes and $92,000 lost on the sale of stock. The $68,000 loss had been allowed as a de-

duction in full in the year in which it had occurred. The Tax Court had found:

> "With respect to the loss of $68,000 resulting from the petitioner's endorsement of the Bowers Company note he testified that in endorsing the notes he was seeking to protect his investment *in his stock.*" (Emphasis supplied)

In denying the carry forward loss, the court found that in no sense could the corporation be regarded as a taxpayer's alter-ego and that since he was not in the business of dealing in securities, nor in that of endorsing notes, it could not be said that these losses were the result of the operation of a trade or business regularly carried on by the petitioner. Rather they "resulted from occasional transactions intended to preserve the value of his *investment* in capital shares".[3]

In neither of these cases was there any evidence, nor did the taxpayer make claim as to any activities of organizing, financing and managing enterprises.

Respondent confesses that:

> "The vital distinction between a 'trade or business' and other activities which, though not incident to a 'trade or business', are nonetheless undertaken for the purpose of profit results in a basic differentiation between *'business' activities* and *'investment' activities.*" (Br. 20) (Emphasis supplied)

He admits (Br. 30) that managing corporations may be a business and, in fact, that being a salaried officer of a corporation can constitute a business.

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[3] **Burnet v. Clark**, 287 U.S. 410, 415; 77 L. Ed. 397, 399.

Respondent admits that lending money can constitute a business. (Br. 30).

He further admits (Br. 12, Ftn. 4) that renting properties can constitute a business.

As has been shown, Petitioner, A. J. Whipple, was over a long period of years, including the years 1952 and 1953, very extensively engaged in all three of these activities as well as other *"business" activities*, and paid tax on ordinary income received from them in the total amount of $94,478.71 as follows:

	1952	1953
Salaries	$29,400.00	$33,450.00
Interest	2,285.35	1,747.59
Rent	15,570.58	12,025.19
Totals	$47,255.93	$47,222.78

Petitioner also paid tax on $56,376.28 ordinary income received from partnership and joint ventures that he had organized as follows:

In 1952	$29,198.37
In 1953	$27,177.91
Total	$56,376.28

The combination of his business activities rewarded him with ordinary income totaling $150,854.99 during those two years. An integral part of Petitioner's business activities was the financing of the corporations, partnerships and joint ventures which he had formed.

Petitioner testified to following a practice of lending them money temporarily as needed and then taking it out

to be used again (R. 92). He said this practice continued over a period of ten years (R. 92) and was still being followed in 1953 when, in addition to $52,500 lent to Mission Orange (R. 63), he lent $25,000 to $30,000 to another corporation. (R. 121) He collected interest from six corporations in 1952 and from three in 1953. (R. 29) The loans to Mission Orange Bottling Co., Inc., one of the many enterprises he had organized and was managing and to whom he was renting, totalled $131,778.26 during the years 1951-1953, and he was repaid $74,803.16, leaving the net in question of $56,975.10. Therefore, these loans were incurred as a part of his over-all business. To hold that a loss suffered from the becoming worthless of a loan made to one of these enterprises was not suffered in the course of his engaging in a trade or business, would be to apply a sterile and rigid approach that is not contemplated by the statute.

As can be seen from the evidence, as soon as Petitioner sold out his interests to Strickland, he immediately began organizing a lumber company, bought land in two spots to subdivide, and formed a construction partnership, two construction corporations (Tr. 95-96) and a rental equipment corporation (R. 101). He was the moving and dominant person in all these. The very names of the companies were an indication of this.[4] He began a rental business (R. 103), lent money to these and other corporations and partnerships (R. 99) including a club over a restaurant he had bought (R. 104-5) and organized a bottling corporation (R. 114), a soft drinks distributorship cor-

[4] **A. J. Whipple Construction Co.; Whipple Lumber Co.; Dozier Whipple Construction Co.; Whipple Construction Co., Inc.; Whipple Equipment Co.** (R. 99).

poration (R. 112), and a vending machine business (R. 114) and helped promote oil deals. (R. 65)

The great bulk of the salaries of $29,400 in 1952 and $33,450 in 1953, plus the partnership income of $29,198.37 in 1952 and $27,177.91 in 1953 received by Petitioner were not for the conduct of the actual businesses in which the corporations and partnerships were engaged, but for managing them. He certainly didn't nail any boards, serve any steaks to customers in his restaurant or cap any bottles. In fact, he was not actively engaged in the day to day operation of any of his corporations unless its problems demanded some special concentrated attention, except as it involved matters of policy, of finance, coördination or coöperation with some of his other enterprises.[5]

He wouldn't have had time to have to be actively engaged in the business activities of bottling drinks in Lubbock, subdividing real estate in Angleton, supervising the construction of houses in Pasadena, overseeing the dis-

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[5] The distinction between these is shown by the following testimony of Mr. Barnhart, the Mission Dry representative (R. 57):

"Q. On these occasions that you met Mr. Whipple in Lubbock, Texas, what did you discuss with Mr. Whipple?

A. Well I discussed the business operation of the business with him.

Q. And did you discuss anything about the affairs and manner of handling the business?

A. Yes, sir.

Q. Are they the type discussions that you would have with the manager of a business?

A. No, sir. It was not from just—if you are referring to a resident manager or—

Q. I mean an overall general manager.

A. Yes.

Q. You had, I take it, several occasions to talk with Mr. Whipple; is that correct?

A. Yes, sir."

patching of trucks from the lumber yard in Houston, distributing soft drinks in Amarillo, greeting customers in Cousin's Restaurant, or checking the oil lease records in Washington and Lee Counties.

The final strawman the Respondent set up was that of a taxpayer's organizing, financing and managing a single corporation, saying:

> "* * * In short, if the present taxpayer's activities are confined to a single corporation, then no matter how extensive and continuous these activities may be they would not, under *Dalton* and *Clark*, constitute a separate business of 'organizing, managing, and financing.' Indeed, we are aware of no decision holding that such activities, when undertaken with respect to a single corporation, and with the sole purpose of enhancing the taxpayer's interest as stockholder of that corporation qualify as a 'trade or business.'"

This again is a supposition that has no harmony with reality and no applicability to what really was the nature of Whipple's enterprises. If he wanted to, how would one get all of the varied types of business in which he was interested in one corporation?

Furthermore, and even more important, to assume that Petitioner, himself, *could* have done so, had he wanted to, is to ignore an important aspect of his business of organizing, financing, managing and equipping corporations—that of interesting other persons in going into various businesses with him. Mr. Finley, the Mission Orange manager, would hardly have fitted into the construction business, nor is there any evidence Knostman and Webster (R. 45) were interested in investing in a restaurant. Being a partner in

constructing houses does not mean you are interested in the oil business. Certainly, Mr. Head was not interested in investing in what he characterized as "that tiger out in Lubbock". (R. 66).

Respondent's statement:

> "Indeed, whether a taxpayer conducts all phases of his operations through a single large corporation, or, instead, embodies each phase or enterprise in a distinct corporate entity, is largely a matter of choice, the difference frequently amounting to little more than a matter of bookkeeping."

shows a lack of understanding of business and the problems and demands of business management.

We have shown the very good reasons why all these many different business activities carried on in many different localities with many different people were conducted in many different corporations, partnerships and joint ventures, and hence it was not simply "a matter of choice" like a choice of color of a necktie, as the Respondent would imply, or as he said "frequently amounting to little more than a matter of bookkeeping."

The matter of bookkeeping, which he belittles, takes active and constant management to see that there are sufficient funds in the various enterprises at all times to pay the bills and keep up their credit and yet have no unnecessary amounts remaining idle in any one enterprise.

What was recognized by the Court in *Foss v. Commissioner* (1 Cir.), 75 F. 2d 326, 35-1 U.S.T.C. para. 9091 (1935), and has been the basis of the long line of cases that have followed it since, is that, in order to organize,

arrange for and keep in touch with the financing of, coördinate the various activities of, and make the general policy decisions for a group of enterprises, as in the *Whipple* case varying from a retail lumber yard, to a restaurant, to various phases of a soft drinks enterprise in Lubbock and Amarillo, rental properties, promotion of oil deals, subdivision of real estate in Pasadena, Angleton and Bellaire, construction of houses in different locations, managing an equipment rental corporation and other activities, would necessarily take such extensive time, thought and efforts of the taxpayer, completely separate from the actual business operations of each of the enterprises themselves, as to constitute a business in itself, which does not exist in the case of the single corporation. This is the basis of the decisions of the cases of multiple corporations.

CONCLUSION

In his original brief, Petitioner traced in detail the interpretations of the Congressional intent by the courts, and the Treasury Department, to show that the restrictive interpretation put upon Section 23(k) by the lower courts in this case was not that intended by Congress. In doing this numerous cases were cited to show how the law stood when the comprehensive Internal Revenue Code of 1954 was passed re-enacting the statute as it had been, and thus confirming the interpretation of the courts as of that date.

These cases were analyzed in detail to show the status of the law existing at the time of the enactment of the Internal Revenue Code of 1954, the continuance of the

rule by a substantial number of cases and what a radical departure from this long line of cases the decision of the lower courts was in requiring that the corporations must be organized for sale. The Respondent admits in his brief that such a requirement is completely without practical application. (Br. 28).

Furthermore, the Respondent admits that in order to establish even the somewhat broader rule that he proposes[1] that the *Foss* case, and many of the other long-standing cases[2] cited by the Petitioner to show that the rule of the lower courts was wrong must be overruled. Petitioner does not agree that these cases should be overruled, since they have received the approval of Congress and are based on sound tax principles.

Petitioner points out in his brief that the facts of his case take it far beyond most of those in which business bad debt treatment has been allowed. For instance, the Petitioner was not just in the business of organizing, managing and financing corporations carrying on one particular type of business activity as in the *Campbell*[3] case, and, furthermore, he was carrying on business activities involving leasing to these corporations, an activity not present in that case. On the other hand, in some of the other cases there was no evidence that the taxpayer carried on any such

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[1] "Organizing, financing and managing one or more corporations does not constitute a 'trade or business' of a taxpayer-stockholder if he engages in these activities without compensation, looking for his reward solely to an increase in the value of his corporation's stock." (Br. 23).

[2] See footnote 4 on page 12 of Respondent's brief.

[3] **Campbell v. Commissioner,** 11 T.C. 510, Acq. 1949-1 C.B. 1

extensive activity of organizing and managing corporations as did the Petitioner. In very few, in fact, was the element of renting to the corporations present. Many of the other cases where *business* activities have been recognized involved far less financing, not only as to amounts, but regularity of history over a long period of years, as does the case of Petitioner.

Few of them show the strong evidence of the income received for managerial services that Petitioner's does.

Actually, disregarding all the strawmen, if Respondent's brief is carefully analyzed, it boils down to the real statement of the rule as being the basic differentiation between *business* activities and *investment* activities. (Br. 20)

As shown earlier in the brief in detail, Petitioner engaged in extensive activities of organizing, financing, managing and leasing to corporations, partnerships and joint ventures primarily for the purpose of creating entities to supply him with ordinary income in the form of salaries, interest, rents and partnership profits. There is no contention, at all, that he engaged in these activities for the purpose of enhancing the value of his corporate stock to sell it, and the evidence shows that his dividend income was relatively negligible.

Respondent tries to dismiss these extensive, regular and varied business activities resulting in $150,854.99 of ordinary income in a period of two years, as opposed to $3,300 of investment income, as a "scattergun claim". Respondent's use of such a superficial term cannot be because he fails to understand the applicability of the facts of Petitioner's case to the rule which he, himself, expounds; it

must be that he has no way of refuting the fact that Petitioner falls under it.

It is respectfully submitted that the abundant facts of Petitioner's case show that his activities were those of a businessman and not those of a mere investor, so that the only way the decision of the lower courts could be affirmed is to adopt a rule which would throw Petitioner Whipple and all similar enterprising and progressive small businessmen in the same category as the taxpayer in the *Higgins*[4] case, who never participated in any business or managerial activities but, who made his investments from a French chateau.

PRAYER

Petitioner prays that the judgments of the Tax Court and the Court of Appeals for the Fifth Circuit be reversed and rendered by this Honorable Court.

The case should be reversed because the Courts below applied an incorrect legal standard to the activities of Petitioner, A. J. Whipple, in determining that the $56,975.10 bad debt loss he sustained was not incurred in his "trade or business" as used in Section 23(k)(4) IRC 1939.

This case should be rendered and judgment entered allowing Petitioner a business bad debt deduction in the amount of $56,975.10, as prayed for in Petitioner's Petition for Redetermination of the Deficiency because the record clearly shows that the $56,975.10 bad debt of Mission Orange Bottling Co. of Lubbock, Inc., was incurred in

[4] **Higgins v. Commissioner**, 312 U.S. 212, 85 L. Ed. 783

Petitioner's trade or business within the meaning of Section 23(k) of the Internal Revenue Code of 1939.

Respectfully submitted,

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PROOF OF SERVICE

It is hereby certified that five copies of the above and foregoing Reply Brief of Petitioner were served on Archibald Cox, Solicitor General, Department of Justice, Washington 25, D. C., by depositing the same in the United States Post Office at Houston, Texas, air mail postage prepaid on this_____day of March, 1963.

_____
Counsel for Petitioners